



SC PRIVATE LETTER RULING #89-13

TO: XYZ

SUBJECT: Corporate Income Tax

DATE: July 19, 1989

REFERENCE: S.C. Code Ann. Section 12-7-230 (Law. Co-Op. Supp. 1988)
S.C. Code Ann. Section 12-7-640(2) (1976)

AUTHORITY: S.C. Code Section 12-3-170
SC Revenue Procedure #87-3

SCOPE: A Private Letter Ruling is a temporary document issued to a taxpayer, upon request, and it applies only to the specific facts or circumstances related in the request. Private Letter Rulings have no precedential value and are not intended for general distribution.

Question:

Do the activities of XYZ constitute a substantial nexus with South Carolina to justify the Commission's imposition of an income tax on XYZ's interstate earnings derived from the hauling of freight into and across South Carolina?

Facts:

XYZ is an interstate motor carrier of freight under contract with X. From its out of state terminal, XZZ hauls and delivers freight to X retail outlets located in South Carolina and other surrounding states. XYZ does not own, lease nor rent terminal space in South Carolina. XYZ's in-state activities stem from their use of South Carolina's highways to haul freight into and across South Carolina.

The Commission issued a Notice of Assessment to XYZ, imposing penalties and interest for their failure to file a South Carolina corporate income tax return as required by S.C. Code Section 12-7-230. XYZ opposes this assessment stating that since they are engaged exclusively in interstate commerce and, therefore, not "doing business" within South Carolina, they are immune from South Carolina's corporate income tax. XYZ further asserts that the tax:

- (1) is not applied to an activity having a substantial nexus with South Carolina, and
- (2) is not fairly related to the services provided by South Carolina.

Discussion:

S.C. Code Section 12-7-230 provides in part:

...every corporation organized under the laws of this State, doing or transacting business partly within and partly without this State, shall make a return and shall pay annually an income tax equivalent to five percent of a proportion of its entire net income to be determined as provided in this chapter, and except as otherwise provided, every foreign corporation transacting, conducting, doing business, or having an income within the jurisdiction of this State, whether or not the corporation is engaged in or the income derived from intrastate, interstate, or foreign commerce, shall make a return and shall pay annually an income tax equivalent to five percent of a proportion of its entire net income, to be determined as provided in this chapter. The term "transacting", "conducting", or "doing business", as used in this section shall include includes the engaging in or the transacting of any activity in this State for the purpose of financial profit or gain.

S.C. Code Section 12-7-640(2) establishes the method for apportioning interstate income generated by motor carriers:

- (2) Motor carriers of property and passengers. - Motor carriers of property shall apportion their net apportionable income to South Carolina by the use of the ratio of vehicle miles within South Carolina to total vehicle miles everywhere.

Thus, the Commission seeks only to tax that portion of XYZ's interstate income generated within the borders of South Carolina.

South Carolina's jurisdiction to impose tax on interstate motor carriers is subject to the Federal constitutional limitations of the Commerce Clause and Due Process Clause. It is well settled that "interstate commerce is not immunized from carrying its fair share of the costs of the state government in return for the benefits it derives from within the state." Northwestern States Portland Cement Co. v. Minnesota, 358 U.S. 450, 461-62 (1959).

In Complete Auto Transit, Inc. v. Brady, 430 U.S. 274 (1977) the U.S. Supreme Court developed a four prong test to determine whether a state tax is constitutional:

- (1) Is the tax applied to an activity with a substantial nexus with the state,
- (2) Is the tax fairly apportioned,
- (3) Does the tax discriminate against interstate commerce, and

- (4) Is the tax fairly related to the services provided by the taxing state.

Unlike the Commerce Clause, which is a grant of authority to Congress to regulate interstate commerce, the Due Process Clause specifically limits the state's power to impose taxes. Before a state can exercise its power to tax income derived from the activities of interstate commerce, the tax must first pass Due Process scrutiny:

- (1) "no tax may be imposed unless there is some minimal connection (nexus) between those activities and the taxing state, and
- (2) "the income attributed to the state for tax purposes must be rationally related to the values connected with the taxing state. Moorman Mfg. Co. v. Bair, 437 U.S. 267, 272-73 (1978).

The taxpayer has questioned (1) whether its' activities within South Carolina create a "substantial nexus" and (2) whether the tax is "fairly related to the services provided" by South Carolina. An analysis of these requirements follows:

1. "The requisite 'nexus' is supplied if the corporation avails itself of the 'substantial privilege of carrying on business' within the taxing state." Mobil Oil Corp. v. Commissioner, 445 U.S. 425, 436-37 (1980), quoting Wisconsin v. J.C. Penny Co., 311 U.S. 435, 444-45 (1940). It is well settled that common carriers for hire make the highways their place of business. Aero Mayflower Transit Co. v. Board of R.R. Comm'rs of State of Montana, 322 U.S. 495, 503 (1947). Thus, XYZ's argument that mere use of South Carolina's highways to haul freight into and across South Carolina on an interstate basis does not constitute doing business within South Carolina is without merit.

XYZ's argument that they do not generate income while hauling freight into and across South Carolina is also without merit. The U.S. Supreme Court has held that the income of a unitary business is derived from a series of transactions, each of which contributes toward the production of the income. Underwood Typewriter Co. v. Chamberlain, 254 U.S. 113, 120-21 (1920); Bass v. State Tax Comm., 266 U.S. 271, 282 (1924). In Mercury Motor Exp. v. South Carolina Tax Commission, the South Carolina Supreme Court cited with approval the Court's "series of transactions" analysis and upheld an income tax levied against an interstate motor carrier transporting property along South Carolina's highways. 244 S.C. 134, 135 S.E.2d 756, 759 (1964).

In upholding the income tax, the court reasoned:

"The appellant (Mercury Motor) operates a unitary business and its gross income and, therefore, its net income, is derived from a series of transactions. Here the series of transactions consists of the solicitation of freight, the picking up of freight, the hauling of freight, the delivery of the same and the collection of charges therefor. Each transaction in the series contributes to the earnings and net income of the appellant, and, while each transaction is necessarily incidental to the production of

its income, the transaction which primarily earns the income is the hauling of the freight. It seems to us to follow that as the trucks of the appellant move along, through and over the highways of the State of South Carolina, the appellant is engaged in income producing activity actually done and performed within the borders of the State of South Carolina." Id. (emphasis added).

A review of the Highway Fuel Use Tax Quarterly Reports for the years 1987 and 1988 indicates that XYZ's trucks traveled approximately 1.71 and 2.28 million miles, respectively, across South Carolina's highways. As the South Carolina Supreme Court reasoned, each of these miles contributes toward XYZ's production of income.

XYZ also filed a Certificate of Public Convenience and Necessity for the Operation of Motor Vehicle Carriers with South Carolina's Public Service Commission to obtain a Class F license which permits XYZ to deliver freight into South Carolina. The privileges associated with this license unquestionably enhances XYZ's business relationship with X; the contract of which comprises a substantial source of XYZ's income.

Since XYZ is a common carrier for hire whose regular and continuous use of South Carolina's highways constitutes "doing business" within South Carolina and since XYZ's primary income producing transaction is the hauling of freight, XYZ's use of South Carolina's highways to haul freight into and across South Carolina adequately provides the requisite minimal connection between XYZ's in-state activities and South Carolina.

2. The second requirement is satisfied under the "benefits of civilization test" which provides:

"A tax is not an assessment of benefits. It is a means of distributing the burden of the cost of government. The only benefit to which the taxpayer is constitutionally entitled is that derived from his enjoyment of the privileges of living in an organized society, established and safeguarded by the devotion of taxes to public purposes." Commonwealth Edison Co. v. Montana, 453 U.S. 609, 622-23 (1981).

The test is not a comparison of the amount of tax assessed and the cost to the State of the benefits it conveys to the taxpayer, but rather, that the measure of the tax reasonably relates to the extent of the contact. Id., at 625-26.

"The simple but controlling question is whether the state has given anything for which it can ask return." Wisconsin v. J.C. Penny Co., 311 U.S. 435, 444 (1940). South Carolina provides XYZ with fire and police protection, access to this state's courts and use of our highways for pecuniary benefit. South Carolina builds and maintains these highways. "Motor carriers for hire make especially arduous use of roadways, entailing wear and tear much beyond that resulting from general indiscriminate public use." Aero Mayflower Transit Co., 332 U.S. at 503. Thus, South Carolina's continuous repair and maintenance of these roads conveys a substantial benefit upon XYZ; a benefit which no other state can provide.

Conclusion:

Because XYZ is a common carrier for hire authorized to haul and deliver freight into and across South Carolina, their use of South Carolina's highways results in their "doing business" within South Carolina, thereby, establishing substantial nexus with South Carolina. Because the use of our highways is crucial to the successful operation of XYZ's business, South Carolina's continuous repair and maintenance of our highways conveys a substantial benefit to XYZ.

Furthermore, South Carolina extends to XYZ the use of South Carolina's courts, fire and police protection and, in general, the benefits of an orderly, civilized society.

Therefore, both Constitutional requirements raised by XYZ have been satisfied and the income derived by XYZ as its trucks haul freight along our highways is subject to South Carolina's corporate income tax.

SOUTH CAROLINA TAX COMMISSION

s/S. Hunter Howard Jr.

S. Hunter Howard, Jr., Chairman

s/A. Crawford Clarkson Jr.

A. Crawford Clarkson, Jr., Commissioner

Columbia, South Carolina
July 19, 1989